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August 25, 1993

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: Implementation of the Cable Television Consumer Protection and Competition Act of 1992 -- MM Docket No. 93-215

Dear Mr. Caton:

I enclose an original and nine (9) copies of the Comments of Counsel for the Municipal Franchising Authorities in the above captioned proceeding.

Any questions regarding this submission should be referred to the undersigned.

Sincerely,

Janice L. Lower

Janice L. Lower

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 Rate Regulation	)	MM Docket No. 93-215

TO: THE COMMISSION

COMMENTS OF COUNSEL
TO THE MUNICIPAL FRANCHISING AUTHORITIES

I. INTRODUCTION

Duncan, Weinberg, Miller & Pembroke, P.C. and Snavely, King & Associates, Inc.[1] hereby submit comments in response to the Notice of Proposed Rulemaking ("NPRM") in the above-captioned docket, adopted on July 15, 1993, and released on July 16, 1993. In the NPRM, the FCC proposes regulatory requirements to govern cost-of-service showings submitted by cable operators seeking to justify rates above levels determined under the Commission's established primary method of regulating basic service tier rates, the benchmark and price cap approach. The FCC issued the NPRM in response to its concerns that the record created in the Rate Regulation Docket, MM Docket No. 92-266, was not sufficient

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[1] Duncan, Weinberg, Miller & Pembroke, P.C. is a law firm which has previously filed extensive comments on behalf of the Municipal Franchising Authorities ("MFA") (a group of thirty-six franchising authorities in eight states) on the Federal Communications Commission's ("FCC") proposed rate regulation and customer service rules under the Cable Act of 1992. Snavely, King & Associates, Inc., is economic counsel providing economic consulting services to municipal franchising authorities in their regulatory activities under the Act and the Commission's rules. Together, they will be referred to herein as "MFA counsel".

to permit the balancing of consumer and cable operator interests that should be embodied in a cost-of-service approach, and seeks by this NPRM to create the record necessary to adopt cost-of-service requirements. NPRM at 5, Paragraph 5.

In these comments, MFA counsel urges the FCC to reconsider its proposal to adopt a generic cost-of-service approach, and instead urges the Commission to determine that the existing benchmark and price cap approach is just, reasonable, and fair, and that the case-by-case utilization of the cost-of-service approach already established provides sufficient opportunity for achieving a complete regulatory approach to regulation. Nevertheless, should the Commission conclude that a complete regulatory framework for cable rate regulation requires a more comprehensive cost-of-service regulatory scheme, MFA counsel urges this Commission to consider the issues raised herein in designing that framework for implementation.

II. BACKGROUND

In Rate Regulation Docket MM No. 92-266, the Commission understandably adopted a primary benchmark/price cap approach, given its own extensive experience in the rate regulation business. Rate regulation can be very complicated, costly and time-consuming. Cost-of-service rate regulation requires knowledge of many esoteric variables, complex formulas, and industry practices, and almost always requires the assistance of attorneys, accountants and economic consultants.

In establishing the benchmark and price cap formula in MM Docket No. 92-266, the Commission struck a fair compromise:

it gave cable operators the exclusive option to elect to present a cost-of-service showing to justify rates **above** those established under the benchmark system. The Commission declined to permit local and state cable television authorities to undertake an initial cost-of-service showing to establish rates for the basic service tier **below** those established under the benchmark system (but if a cable operator chose a cost-of-service approach, and costs justified a rate reduction, the regulator may lower rates). Thus, in practical terms, the benchmark mechanism establishes a floor for cable television rates: no rational cable television operator would elect to present a cost-of-service showing if there were any serious risk that, upon careful scrutiny and analysis, rates could be set below the benchmark.

Under any regulatory scheme allowing a cost-of-service analysis, cable operators will elect cost-of-service showings when they are fairly confident of their likelihood of success. Therefore, should the Commission adopt this approach on a widespread basis, it may be anticipated that much regulatory activity by municipal franchising authorities will be on a cost-of-service, and not a benchmark and price cap, basis.

While this Commission's concern for the health of the cable industry derives from the FCC's overall regulatory mandate, the FCC should bear fully in mind that successful cost-of-service showings will result only in higher rates for consumers than the benchmark mechanism, at considerably greater effort and cost on the part of local regulatory authorities as to the basic service tier, and on the part of the FCC, as to the cable programming service tier. The increased effort and expense to both the local regulators and to the Commission may well chill the desire of those regulators to take full advantage of the opportunities to establish just and reasonable rates, as provided by Congress in the Cable Act of 1992.

For large metropolitan areas with many thousands of cable subscribers and significant financial resources, conducting a full-blown cost-of-service analysis would be an involved but worthwhile undertaking. But for a small city or town, with two or three thousand subscribers, to hire lawyers and economists who can teach the cost-of-service concepts to the City or Town Council members or the members of the local cable committee, to analyze the cost-of-service information sufficiently, to conduct hearings, and to understand the complicated economic concepts clearly enough to reach a reasonable result, will all be far beyond what seems reasonable under the authority given to the municipality by Congress to make sure its cable television rates are proper. And it is hard to envision how the FCC, already feeling the burden of its vastly increased regulatory role, will be able to conduct what could be hundreds of cost-of-service proceedings relating to the programming tier rates.

Should these scenarios be the conceivable or predictable result of this NPRM, then the FCC should very seriously examine whether a generic cost-of-service approach sends the wrong signal to both operators and franchising authorities, and whether it in fact completely undermines Congress' overall intent.

From the point of view of local cable regulatory bodies, therefore, the cost-of-service mechanism does not offer much "WIN-WIN" potential. As a general principle, local authorities would prefer to see the Commission return to the benchmark approach, and direct its efforts at refining that approach to better address some of the concerns of the cable industry. The cost-of-service mechanism designed, or refined, in this proceeding, should be used only in very limited, exceptional circumstances, since it will produce higher rates at greater cost and effort than those permitted under the benchmark system. In this regard, we support the Commission's proposal, in Paragraph 18 of its NPRM, to limit cost-of-service showings as to initial regulated rates to "special circumstances of extraordinary costs". This facilitates prompt initiation of rate regulation, for the benefit of subscribers, without undue burden on local franchising authorities and, by definition, without unduly prejudicing cable television systems.

Should this Commission determine that a generic cost-of-service approach is still appropriate to develop for the cable industry, the MFA counsel presents the following specific comments on the FCC's NPRM.

III. COMMENTS ON COST-OF-SERVICE REGULATORY FRAMEWORK

A. Regulatory Goals

In the NPRM, the FCC describes a tentative framework whereby cable systems can initiate proceedings that allow them to exceed the benchmark for rates, which benchmark was established by the FCC in its earlier Rate Regulation Report and Order.[2/] This deviation from the benchmark approach would be allowed if a cable company could prove that its costs, as shown in a cost-of-service study, exceeded the benchmark rate. This most recent NPRM solicits comments on how the FCC should establish the rules that would govern cost-of-service studies and procedures for the cable industry under such a cost-of-service approach. In particular, the Commission states that "a goal for the cost-of-service requirements we ultimately adopt in this proceeding will be that they form a 'backstop' for the benchmark approach to rate regulation."[3/]

This task is a great deal more complex and difficult than it initially appears, because any system that mixes regulatory concepts, in this case the concept of benchmarks and cost-based pricing, opens itself up for "gaming the system."[4/] Assuming that cable companies act rationally in the interest of maximizing the return to their stockholders, they could engage in a variety of practices to increase the cost of service of some affiliate companies, decrease the cost of service of other affiliate companies and then file cost-of-service studies on the companies with inflated costs. They would thereby maximize the benefit of their low-cost subsidiaries under the benchmark plan

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2/ Report and Order and Further Notice of Proposed Rulemaking, FCC 93-177, MM Docket No. 92-266 (adopted April 1, 1993; released May 3, 1993).

3/ NPRM at 6, ¶ 7.

4/ "Gaming the system" is a process of using regulations to gain advantage in a way that was unforeseen by the agency establishing the regulations.

and maximize the benefit of their high-cost subsidiaries under the cost-of-service plan.

Bearing this worst case, but logical, scenario in mind, the Commission should reach a conclusion that advocates minimal regulatory complexity, prudent expense, accurate depreciation, a rate of return that is in alignment with comparable industries and careful monitoring of affiliate transactions. Throughout the consideration of this proceeding the Commission should be mindful that Congress reestablished cable regulation specifically to end price gouging of American cable television consumers, and that regulations that inadvertently allow the circumvention of that mandate would be a disservice to cable consumers and contrary to Congress' intent.

Eventually the goal of a cost-based system should be to establish rates that emulate the rates of a comparable competitive industry. The local exchange telecommunications industry, for example, which is comparable to the cable television industry, has begun to experience some competition. As a result, the price of local services has increased by less than the Consumer Price Index for All Goods and Services (CPI). Cable rates, not yet subject to competition, have risen by amounts much greater than the CPI.

The Commission has asked "whether our regulatory framework for cost-based rates should be guided by the goal of producing rates that approximate competitive rate levels, i.e. rates that approach the operators' costs."[5/] In this question is

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5/ NPRM at 8, ¶ 10.

an implied assumption that what the operators report as costs is not inflated by the wasteful management practices that naturally follow from being an unregulated monopoly. The Commission's goal is appropriate; however, rates should approach not what the operators' costs are, but what they might be if they were lean, competitive companies.

As suggested by the Commission, a tier-neutral approach to cable service rate structure is reasonable. If rates give incentives for channels to move from the basic to the expanded basic or the programming tiers, poorer consumers will lose service with no economic benefit. This is something Congress did not intend.

The NPRM also requested comment on the economic impact of cost-based rates on the cable industry and consumers.[6/] The clear result of allowing both a benchmark system and a company-initiated cost-based system to exist simultaneously will be an increase in the profits of the cable companies, at the expense of cable consumers. More importantly for franchising authorities, it would also vastly increase the cost and complexity of regulatory proceedings at a local level--to an extent that may preclude regulation altogether for some of the smaller municipalities. In a simple benchmark system, without the cost justification process, inefficient or high-cost companies would be required to lower costs, or their shareholders would receive less of a return on equity where rates were lowered through regulation. Low-cost companies would, in theory, already

6/ NPRM at 9, ¶ 14.

be at or below the benchmark. The overall results of a benchmark system would be a larger return for a low-cost company and a small return for a high-cost company.

A cost-of-service system, in its purest form, only works if the extraneous factors affecting a company's cost structure are identical to those of other companies. Pure cost-of-service systems, with a standard rate of return, would hold efficiency constant and make allowance for extraneous factors. The shareholders of all companies under a pure cost-of-service system would only gain greater return on equity if there were regulatory lag that allowed them to benefit from increasing efficiency. Neither approach is perfect in meeting the needs of consumers, but the benchmark system sends clearer signals to the industry.

However, mixing the two systems could be an even more imperfect solution. If all differences in cost-of-service were due to efficiency, under the mixed approach all inefficient companies would file for cost-of-service based pricing while efficient companies would choose to remain under the benchmark. The consumers of services in efficient company areas would pay the benchmark, but their cable company would be making windfall profits off monopoly service. The consumers of services in inefficient company areas would pay a higher price for the same or worse service. If all differences in cost of service were due to extraneous factors, then companies in high-cost areas would file for cost-of-service based pricing and those in low-cost areas would stay under the benchmark. Consumers in low-cost areas under such a scenario would be paying rates that allowed a high rate of return to their company without any increased benefit to the consumer.

These hypothetical scenarios are instructive for determining the extremes that describe the range of possibilities in which a much more complicated reality will most likely fall. However, they also point to the power that companies could exercise if they had the total discretion to choose the regulatory system under which they would operate.

If a mix of the two systems is put into place by the Commission, local franchising authorities should be granted increased latitude when making decisions regarding a company's request to be switched from one regulatory system to another. In such circumstances, regulatory bodies should be given the power to determine the actual basis of cost differentials from the national norm. The local franchising authority should be able to determine whether high costs claimed by cable companies are the result of inefficient, unsupported costs and internal company decisions or extraneous factors such as local taxes. In addition, local franchising authorities should be given the authority to initiate cost-of-service hearings themselves, should they wish to do so.

B. Regulatory Requirements

1. Procedural Requirements for Cost-of-Service Showings

a. Frequency of Cost-of-Service Filings

> We propose to establish limits on the frequency with which cable operators may make cost-of-service showings for the basic

> service tier and cable programming services tier. We propose that once a cost-of-service showing has been evaluated by either the local franchising authority or the Commission, another such showing for the tier may not be made for one year. We solicit comment on this proposal.[7]

The Commission's proposal that there be a limit to the frequency with which a cable company can file cost-of-service studies is appropriate, since it will minimize the burden imposed by the cable companies upon regulatory bodies. Indeed, a three-year regulatory cycle would be appropriate for company initiated cost-of-service showings, with the exception that regulatory authorities should be given the discretion to initiate off-cycle showings, based on reported cost information of the cable operators. At a minimum, the Commission should direct that a new cost-of-service showing cannot be submitted until the decision regarding the previous cost-of-service or benchmark/price cap proceeding has become "final", and is no longer subject to administrative or judicial review. Otherwise, multiple proceedings could be pending at the same time, given the time that can be consumed by review processes.

However, the possibility should remain open for consideration to be given to economic circumstances that would require an earlier initiation of a cost-of-service hearing. The cable industry is a declining-cost industry. Many of the services of cable companies are based on microprocessor-based technologies (which are decreasing in price as they increase in processing speed and memory capacity), fiber optic technologies

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7/ NPRM at 11, ¶ 17.

(which are decreasing in price and increasing in circuit capacity through technological development) and metallic cable technologies (which are also increasing in usable circuit capacity through innovation). These factors, external to the cable systems themselves, are but one basis of the cable industry's declining cost profile.

Additionally, it may be anticipated that factors internal to cable systems' management will add to the industry's declining cost structure. Prior to regulation, economic theory would indicate that cable companies would operate with a management and operations style of an unregulated monopoly. Without economic incentive through competition or regulation, management would have no pressure for efficiency. Subsequent to regulation, which emulates a competitive market, management will be under review, and theory would indicate that such an industry would become more efficient. This should add to the declining-cost profile of the cable television industry.[8/]

In order to obtain reported information in the most efficient and useful form possible, cable companies and operators should be required to file annual financial reports based on or in a format similar to the Automated Reporting Management Information System (ARMIS) reports currently required of the

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8/ This declining-cost profile of the industry should be borne in mind when formulating regulatory policy. If allowed to "lock in" prices based at the high end of a declining cost slope, the cable companies will have a steadily increasing rate of return. This may result in windfall profits to cable companies at the end of their self-governed regulatory cycle. Sufficient reporting mechanisms and increased regulatory power to initiate cost-of-service showings are two possible remedies to this problem.

Telephone Local Exchange Companies (LECs). This would allow regulatory authorities to have the information to initiate cost-of-service proceedings preemptively when costs drop to levels sufficient to justify the expense of a new proceeding. With the cost-of-service information available to local regulatory authorities on an annual cycle, to be used if needed, the formal review process could be lengthened to a triennial cycle, reducing the administrative and regulatory costs of proceedings.

b. Special Circumstances or Extraordinary Costs

> We solicit comment on whether we should establish procedural limits or bars on cost-of-service showings seeking to justify rates higher that existing rates absent a demonstration of special circumstances or extraordinary costs. Under this approach, absent a special showing, we would not entertain cost-of-service applications to justify initial regulated rates higher than the system's existing rates. This approach would be based on the presumption that most operators have set rates in an unregulated environment at a level to be fully compensatory.[9/]

Cable operators should not be allowed to make cost-of-service showings for existing rates. If the Commission contemplates cost-of-service showings for current rates, cable operators should be required to present overwhelming and preponderant evidence to justify any increase in rates. "Special circumstances or extraordinary costs" should be clearly defined to exclude costs that are the product of mismanagement of the finances or the operations of the company. The shareholders

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9/ NPRM at 11, ¶ 18.

should bear the costs of mismanagement and improper decision making, since that provides their incentive to insure good management in the future. Current rates set by the cable companies are clearly excessive. We would affirm the Commission's presumption as conservative.

c. Use of Forms and Worksheets

> We propose to require that in any cost-of-service showing, costs and supporting data be presented on an FCC prescribed form and associated worksheets. . . . We believe that use of such a form would generally reduce administrative burdens by providing for a uniform presentation of development of cost-based rates for cable service. We solicit comment on this proposal.[10/]

Franchising authorities that will be regulating under rules resulting from this proceeding support the Commission for prescribing a form for cost-of-service studies. A uniform format is essential for the smooth transition into a regulated environment for this industry, since it will decrease the "learning curve" associated with the analysis of new studies.

We would further recommend, however, that the Commission require that the prescribed form be drawn up to include both paper and electronic copies of the worksheets associated with filings. We would anticipate that operators throughout the cable industry will produce their cost studies on personal computers in commercially available spreadsheet packages. These tools have become as common in industry today as columnar pads were 20 years ago. Thus, it would be no imposition on the companies to copy their files onto a disk for provision to

10/ NPRM at 12, ¶ 19.

their regulatory authority. Even those companies that use workstations, minicomputers and mainframe computers could easily transfer their data and calculations to a standard ASCII[11/] format on a floppy disk. The important point of such a requirement would be that it would save regulators from having to replicate a company's calculations in a proceeding. This would save time and make the process of regulating cable companies simpler and more standardized.

2. Cost-of-Service Standards

The Commission has come to proper and well-reasoned tentative conclusions on almost all of the points raised in the NPRM. Therefore, we suggest below points and issues for the Commission to consider only in addition to its proposed analysis.

a. Transition Elements

> We solicit comment on the extent to which we should establish in our regulations explicit transition elements addressing the changes in financial practices and structure required by cable operators as they adapt to a rate regulated environment.[12/]

We do not support the use of transition elements. Such elements would be open to manipulation and differing interpretations that would unnecessarily complicate regulatory proceedings and cost-of-service showings. If any such elements are included, they should be absolutely explicit and limited in their application and timing.

11/ American Standard Code for Information Interchange, a generic standard in the American computer industry.

12/ NPRM at 13, ¶ 22.

b. Annual Expenses

> We propose that a cost-based showing permit the cable operator to cover operating expenses, depreciation, and taxes as annual expenses of providing cable service. We will prohibit recovery through regulated cable rates of expenses unrelated to provision of regulated cable service. We solicit comment on these tentative conclusions.[13/]

The cost of service of cable television should not be muddied with the success or failure of a cable company's miscellaneous unrelated operations If a cable company makes an excellent investment in a wholly unrelated field and it is successful, the shareholders of the company should benefit. If it is unsuccessful, the shareholders of the company should bear the burden. In no case should the price of the consumers' cable television, or the cost structures upon which that price is based, be affected.

c. Operating Expenses

The Commission's tentative conclusion that plant specific costs, plant non-specific costs, customer operations, and corporate operations should be included as operating expenses is appropriate. Though not listed in the NPRM, any expenses associated with the lobbying of elected officials should not be included in the allowed expenses, whether classified as advertising or not. As the cable companies have themselves advocated in some telecommunications regulation cases, consumers

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13/ NPRM at 14, ¶ 23.

should not have to bear the costs of cable companies' lobbying efforts.

d. Depreciation

> We tentatively conclude that we should prescribe depreciation rates for purposes of developing cost-based rates for regulated cable service. This prescription could be an industry-wide depreciation rate or band of reasonable rates or individual rates for each plant category. We could also require cable operators to use company-wide expense as reported on . . . SEC financial statements, link depreciation to the specific circumstances in each franchise, or adopt some other standard. We seek comments on these alternatives.[14/] (footnotes omitted)

The Commission should prescribe depreciation rates for purposes of developing cost-based rates for regulated cable service. Indeed, in capital intensive industries such as the cable industry, the most significant element of a cost-of-service study is depreciation expense. Since Generally Accepted Accounting Principles do not prevent cable operators from selecting accelerated and excess depreciation rates, the prescription of rates by the Commission is essential. Cost-of-service studies based upon company-selected depreciation rates would be meaningless.

The Commission has prescribed telephone depreciation rates for nearly 50 years, and its expertise is unsurpassed in this area. The Commission should apply to the cable industry all of the methods and procedures it uses to prescribe depreciation rates for local exchange telephone companies.

14/ NPRM at 16, ¶ 27.

e. Taxes

> We propose to allow, in determining a cable operator's annual expenses, taxes incurred in the provision of regulated cable services.[15]

The inclusion of taxes (subject to review for accuracy during the regulatory proceeding) incurred in the provision of regulated cable services in the annual expenses of cable operators is appropriate.

f. Ratebase

(1) Plant in Service

Used and Useful and Prudent Investment Standards

> In other rate-regulated industries, the costs that the company may include in the ratebase have been determined by applying the used and useful and prudent investment standards to the original construction cost of the assets dedicated to service. We tentatively conclude that we should adopt these standards to govern the costs that may be included in plant in service. We seek comment on this tentative conclusion.[16]

The used and useful and prudent investment standard for inclusion of an asset in the ratebase is a very important concept in the proper regulation of industries, and the Commission's tentative conclusion is highly appropriate. Without the "used" criteria, cable television ratepayers would be saddled with the burdens of stranded plant and overbuilt plant in the ratebase. Management would have no incentive to be prudent and efficient in investments and would benefit from the application of a rate of

15/ NPRM at 17, ¶ 30.

16/ NPRM at 18, ¶ 32.

return to an inflated ratebase. Without the "useful" criteria, ratepayers also would be saddled with unnecessary investments, and the management of the cable companies would benefit from making unneeded investments. Without the "prudent" criteria, management would be tempted to engage in the speculative activities that Congress sought to curb through the Cable Act.

Valuation of Plant

> A number of approaches have been, or could be, used to determine the value of plant included in ratebase: market value, original cost, replacement cost, and reproduction cost or a combination of these approaches. Under applicable judicial precedent, regulators have wide discretion to select a methodology for purposes of valuation ratebase, and we will select an approach consistent with that precedent that best implements our balancing of goals for cost-based rates of cable service. We request comments on each approach to valuing plant used and useful in the provision of regulated cable service.[17/]

Original cost is the only legitimate method of determining cost for valuing ratebase. Every other method is subject to manipulation by the cable companies. It is also by far the simplest method of evaluation, and would result in the least amount of regulatory burden to rate proceedings.

> We seek comment on whether the Commission should adopt one valuation methodology for determining initial regulated rates determined by a cost-of-service showing and another for assessing proposed increase in rates of regulated cable services under subsequent cost-of-service showings.[18/]

17/ NPRM at 19, ¶ 33.

18/ NPRM at 19, ¶ 33.

The local regulators of cable franchisees will have in general limited resources for the regulation process. The use of two valuation methodologies would add a dimension of complexity to the process of regulating cable systems that might be burdensome to local authorities. The Commission's tentative conclusion that the original cost method--and only that method--is appropriate to determine the value of a cable operator's plant in service for ratebase purposes is the correct one from the point of view of local regulators.

Excess Acquisition Costs

> The legislative history of the Cable Act of 1992 reveals a Congressional concern that excess acquisition costs may reflect the undue market power of cable operators not subject to effective competition, which has enabled the industry to charge rates higher than would be possible in a more competitive environment. We seek comment on whether Congress intended that we disallow excess acquisition costs.[19/]

It is clear that Congress, in framing the Cable Act of 1992, intended to reduce and control the excessive rate of increase in cable television service prices. In the first paragraph of the findings section of the Act Congress wrote: "The average monthly rate has increased almost 3 times as much as the Consumer Price Index since rate deregulation."[20/] Congress also intended to slow the rampant speculative buying and selling of cable television companies. Section 13 of the Cable Act amended

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19/ NPRM at 21, ¶ 37.

20/ The Cable Television Consumer Protection and Competition Act of 1992, Section 2, ¶ (a)(1).

the Communications Act of 1934 to include a prohibition on selling a cable system within three years of purchase.

These two intentions of Congress, to reduce cable television rates and to limit speculative investing in cable systems, are clearly related. The Discounted Cash Flow (DCF) method of determining the implied amount of future returns on stock in an open market, based upon the current value of outstanding shares and past growth rates, has long been accepted before this Commission in telecommunications cases. The DCF method also shows that there is a direct relationship between the price of a going concern and the implied future income of that company. The price of cable systems has been increasing so rapidly in large part because of owners' assumptions about how much they could charge the consumer of their unregulated monopoly services. The rising prices of services caused escalating prices of systems. That in turn caused speculative investing. All of the excessive acquisition prices charged for cable systems were therefore the result of expectations of excessive revenue streams resulting from excessive prices.

Congress sought to curb excessive prices for cable television services. Allowing the excessive acquisition costs of cable systems to flow back into the rate base to be collected from ratepayers would be a direct circumvention of Congress' expressed design and intent. It would also reward the operators of cable systems that have been speculatively traded at the expense of operators of more conservatively owned cable systems.

> Some or all of the acquisition costs in
> excess of original, replacement, or

> reproduction cost would ordinarily be considered goodwill for accounting purposes. We solicit comment on the extent to which cable operators may reasonably assign a portion of the purchase price of a cable system in excess of value of the plant in service, as determined under the valuation methodology that we select, to intangible assets such as customer lists or franchise rights.[21/]

Goodwill and intangibles are legitimate designations of the value of the good name of a company that has instilled loyalty in its consumers and is likely to give them legitimately won high earnings in the future. Goodwill is not the appropriate term or accounting method for the excess value which an unregulated monopolist can wring out of its captive ratepayer. None of the purchase price of a cable system in excess of value of the plant in service should be assigned to goodwill or intangibles.

> We tentatively conclude that the best balancing of our goals for cost-based rates will be achieved by exclusion of excess acquisition costs from ratebase, including portions assigned to goodwill, customer lists, franchise rights, and other intangible assets. To the extent cable operators on the record of this proceeding can demonstrate a need to allow such costs in ratebase as a transition mechanism or that such costs represent a value to the subscriber, we may alter this conclusion. We seek comment on this tentative conclusion and on its potential impact on the cable industry, subscribers and lenders.[22/]

The Commission's conclusion on this important issue is correct, and should not be altered. Allowing cable companies to

21/ NPRM at 21, ¶ 38.

22/ NPRM at 22, ¶ 40.

continue to grossly overcharge consumers for their services as a "transition" mechanism would be akin to a court allowing convicted embezzlers to wean themselves off the accounts they had been skimming. Many cable companies broke a fundamental trust between themselves and their communities. In exchange for right-of-way and exclusive franchise rights, their charge was to provide cable television service at a reasonable price. Instead, they abused these privileges and charged rates so exorbitant that Congress acted to rein them in.

Should the Commission stand by its conclusion, the most speculative abusers of the public trust will (appropriately) receive smaller profits. More conservative cable companies that have sought to provide a good service at a reasonable price will be unaffected, because their price was not bid up on the assumption of enormous future revenues.

(2) Construction Work in Progress

> We seek comment on whether the Commission should apply the traditional rule under ratebase/rate-of-return regulation that plant under construction will be withheld from ratebase until it meets the used and useful test, but that interest during construction can be capitalized.[23]

The application of the long-standing used and useful criteria for inclusion of plant in ratebase is appropriate, and should be maintained by this Commission. The Commission should not allow cable operators to include construction work in progress (CWIP) in rate base absent a showing of severe financial distress. Several reasons support this conclusion. CWIP is not

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23/ NPRM at 23, ¶ 42.

plant that is used and useful. Customers are not receiving any service from such facilities. Also, the investments that cable operators make are not typically so large in proportion to the overall investment as to warrant such treatment. The financial condition of the operator is not so dependent upon earning a return on new investments as to threaten the viability of the enterprise. Finally, investment in new cable or other plant is generally placed into service quickly enough that CWIP allowances are not necessary. Accordingly, the Commission should exclude any CWIP from rate base, absent a showing of severe financial distress.

(3) Working Capital Allowance

> One approach to handling working capital would be to determine an industry-wide working capital allowance. Another would be to allow individual operators to use a balance sheet approach to determine working capital. This would require a determination of the average difference between current assets and current liabilities. Alternatively, we could require that cable operators study the timing of operating revenues and disbursements (a lead/lag study) to determine the amount of working capital included in ratebase. . . . We solicit comment on each of these approaches.[24/]

The Commission should adopt a zero working capital allowance in the absence of a comprehensive lead-lag study documenting a different result. The billing cycles for cable subscribers should provide cable operators with a cash flow that generally matches the incurrence of expenses.

24/ NPRM at 24, ¶ 45.